



U. S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

March 27, 1998

MEMORANDUM FOR AA/M, TERRENCE J. BROWN

FROM: *for* AIG/A, Everett B. *on* *Carl Otis*

SUBJECT: Audit of USAID's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance, Audit Report No. 9-000-98-003-F

This memorandum is our final report on the subject audit. We received and appreciate your comments on our draft audit report and have included them as Appendix II.

This report contains three recommendations for action. Your comments to the draft report included comprehensive plans for addressing each recommendation. We concur with your plans and believe that, once implemented, these new policies, procedures, and guidelines will correct the weaknesses noted during our audit. They clearly demonstrate management's determination to properly manage the Agency's unliquidated obligations.

Because of our concurrence with your planned improvements, we would normally consider that a management decision had been reached on all recommendations; however, we must withhold our concurrence from Recommendation No. 3. In response to this recommendation you agreed to undertake a comprehensive analysis of the steps and parties involved in managing USAID's obligations and to incorporate these requirements into an Agency-wide training program. We believe the analysis, the resulting changes in policies and procedures, and training program will result in better management of USAID's funds. This report projects that about 5 percent, or \$495 million, of the Agency's unliquidated obligations for project and non-project assistance was excess to current requirements or unneeded as of September 30, 1996. In the absence of readily available information as to the current amount of unliquidated obligations, we believe this projection constitutes the best estimate of the amount of savings that will result from implementation of your proposed corrective actions. We consider Recommendation No. 3 to be an efficiency recommendation. Therefore, although we agree with your plans for implementing the recommendation, we are withholding our concurrence with your management decision pending receipt of comments concerning the amount of potential savings that would result from your corrective actions. Please provide those comments within 30 days.

Management Bureau's Office of Management Planning and Innovation will be responsible for deciding when final management action related to Recommendation Nos. 1.1, 1.2, 1.3, and 2 has occurred.

I wish to express my appreciation for the cooperation extended to Office of Inspector General (OIG) staff in Washington and overseas during this worldwide audit effort.

Background

This worldwide audit was conducted under the direction of the **OIG's** Division of Performance Audits (**IG/A/PA**), with the assistance of auditors from the offices of all six **OIG** Regional Inspectors General. The audit was limited to obligations for project and non-project assistance that had unliquidated balances on September **30**, 1996. It did not cover obligations recorded into a new **USAID/Washington** accounting system, obligations funded with U.S.-owned local currency, obligations for disaster relief, or obligations maintained by **USAID** for the Trade and Development Agency. Records provided by **USAID/Washington** and 39 overseas accounting centers indicated that, as of September 30, 1996, **USAID** had unliquidated obligations for project and non-project assistance totalling over \$9.7 billion. For the purposes of this audit, the unliquidated balance of an obligation was calculated by subtracting the total amount disbursed from the total amount obligated.

IG/A/PA randomly selected sites and obligations for detailed audit work using a combination of stratified, two-stage cluster, and probability-proportional-to-size sampling methodologies. A total of 19 sites (**USAID/Washington** and 18 overseas missions) were selected for review. (See Appendix III for a list of audit sites and site-specific audit reports issued as part of this worldwide effort.)

The data projected throughout this report are estimates of how much of the Agency's total balance of unliquidated obligations (as of September 30, 1996) would have been found to be invalid or in excess of current requirements if the entire universe of obligations had been reviewed.

Audit Objective

The worldwide audit was designed to answer the following question:

Did USAID review and certify its unliquidated obligations for project and non-project assistance in accordance with U.S. laws and regulations and Agency policies and procedures?

Federal agencies are required by U.S. Treasury regulation to review their obligations at least once each year so that they can, among other things, meet a legislative requirement

¹U.S. Department of Treasury Circular No. 965 requires that each agency verify its own accounts at least once each year. Public Law 101-510, Sec. 1405(a) requires the head of each agency "to establish internal controls to assure an adequate review of obligated balances."

to submit a report supported by a certification as to the validity of their recorded obligations.² In addition, USAID guidelines require Agency controllers to initiate and coordinate reviews of all unliquidated obligations at least once each year to determine whether the obligations' balances should be retained or deobligated. Our audit was limited to reviews undertaken by the Agency in order to certify that only valid obligations had been recorded and to identify obligations with excess or unneeded balances. See Appendix I for a discussion of the scope and methodology for this audit.

Audit Findings

Did USAID review and certify its unliquidated obligations for project and non-project assistance in accordance with U.S. laws and regulations and Agency policies and procedures?

In fiscal year 1996, USAID generally reviewed and certified the validity of its recorded unliquidated obligations for project and non-project assistance in accordance with applicable U.S. laws and regulations and USAID policies and procedures. The audit found a few recorded obligations which appeared to be invalid. However, USAID's guidelines for estimating amounts to be obligated and its procedures for reviewing unliquidated obligation balances were inadequate to ensure that all excessive obligation balances were detected and deobligated. Based on a sample of obligations which were tested by the auditors at 19 locations, we projected that \$495 million (5 percent) of USAID's \$9.7 billion in unliquidated obligations was in excess of current requirements or no longer needed as of September 30, 1996.

Excess or unneeded balances were retained and not deobligated by the Agency for a variety of reasons, including inadequate guidance for the enforcement of forward funding guidelines, inadequate reviews, inadequate follow-up of review results, and normal delays in routine financial management operations.

In general, we found USAID processes and practices in fiscal year 1996 to be improved from those found during a series of similar audits we conducted from 1989 to 1994. We believe this resulted from improved guidance issued by the Office of Financial Management of the Bureau for Management (M/FM) in 1993 for the overseas Missions and in 1994 for USAID/Washington and to a budget environment which prompted

²**Concerned** that Federal agencies were recording obligations in situations where no real obligations existed and that information on which to determine an agency's future requirements was not reliable, Congress with the U.S. General Accounting Office and the Office of Management and Budget established criteria for determining the validity of obligations in Section 1311 of the Supplemental Appropriation Act of 1955, now 31 U.S.C. 1501(a). Section 1108(c) of the same title requires that agencies include, with their appropriation requests, a report that the statement of obligations submitted with the request contains obligations consistent with the documentary requirements of 31 U.S.C. 1501(a). The report must be supported with a certification to this consistency.

Agency officials to scrub existing obligations looking for funds that could be programmed for higher priority activities.

Because of the activation of new accounting and management systems in fiscal year 1997, current processes are significantly different from those in place during the period covered by our audit. As a result, recommendations to correct problems noted during the audit have been adapted to reflect weaknesses which were either not corrected by new systems or appear to have been created by the new systems.

New Systems Require New Procedures to Ensure that Only Valid Obligations Are Recorded

We found a few obligations of questionable validity during our audit. We attributed this primarily to Agency controls over the obligation execution process, rather than to its procedures for periodic reviews of obligation balances. We found that although USAID did review its unliquidated obligations in fiscal year 1996, these reviews focused primarily on whether there was a need to retain the unliquidated balances of obligations rather than on whether the underlying obligations met the requirements of 31 USC 1501(a) for valid obligations.

In fiscal year 1997, USAID activated new management systems which significantly changed past practices for executing and recording obligations and deobligations. However, these new systems had significant implementation deficiencies-to the extent that the Controller concluded that it was not possible to review USAID/Washington's obligations in fiscal year 1997. As of the date of our audit, no tests of the new system's ability to prevent the recordation of invalid obligations in USAID/Washington had been conducted. Despite the lack of reviews or tests, the Controller certified at the conclusion of fiscal year 1997 that the Agency's recorded obligations were valid.

As stated above, federal agencies are required by U.S. Treasury regulation to review their obligations at least once each year so that they can, among other things, meet a legislative requirement to submit a report supported by a certification as to the validity of their recorded obligations. According to 31 U.S.C. 1501(a), valid obligations are those that are supported by, among other things, written evidence of a binding agreement between an agency and another person (including an agency), for a purpose authorized by law, and executed before the expiration of the period of obligational availability. If a contract, the document must call for specific goods, real property, work, or services.

M/FM's Deputy Director, now USAID's Acting Chief Financial Officer (CFO), asserted that, in fiscal year 1996 and prior years, USAID met its responsibility for ascertaining and certifying that the Agency's recorded obligations were legally valid by (1) ensuring that obligations sent to M/FM and mission controllers for recording were supported by obligation documents such as contracts or grants and (2) ensuring that information from

these documents was entered correctly into the Agency accounting systems. He noted that, even though guidance required M/FM accounting staff to review obligations for compliance with 31 U.S.C. 1501(a), in reality, M/FM accounting staff had neither the time nor the qualifications to do much more than ensure that documents had appropriate signatures.

M/FM's decision to focus on obligation balances rather than the validity of the underlying obligation may also have been influenced by its consistent, but we believe erroneous, opinion that the validity of an obligation is a changing state-i.e., previously valid obligations become invalid as they expire or become inactive. As a result, accounting staff believed that when they (1) determined that an obligation had expired or would soon expire or (2) reviewed an obligation's balance to determine whether it should be retained or deobligated, they had made a decision regarding the obligation's validity. The Office of the General Counsel shares our opinion that an obligation's "validity" is established at the time of its execution, is based on its conformance to the requirements of 31 U.S.C. 1501(a), and is not affected by its status as either expired, inactive, or excessive. Chapter 571 of the Agency's Automated Directives System issued by M/FM perpetuates this erroneous interpretation by instructing mission controllers and division chiefs that they should report on the validity of their obligations by testing a sample of expired obligations. Not only would such tests be insufficient for an Agency-wide certification of validity, but they would also come too late to prevent unauthorized or improper disbursements in the event the obligations were actually found to be invalid.

USAID/Washington initiated a number of new processes at the beginning of fiscal year 1997, including a decentralized system for recording most obligations. Under procedures in effect during the period covered by our audit, most obligations were routed to M/FM for recording and M/FM served as a central repository for original obligation documents and assumed responsibility for periodic obligation reviews. However, since October 1997, obligations are no longer routed to M/FM for recording, but are recorded directly into the Agency accounting system by the same contract and grant offices which executed the obligations.³ M/FM has taken the position that, because of this change, responsibility for ascertaining the validity of USAID/Washington's recorded obligations has shifted to the Washington offices that executed and actually recorded the obligations. However, this opinion was not institutionalized in either new policy or new procedures.⁴

³An external consultant hired to review the new management systems expressed serious concerns about the adequacy of management controls in the new management and accounting systems. It particularly noted standard controls such as separation of duties were not adequately implemented or enforced. Its report noted that "a user can request and approve a resource" and users of the new system may have been granted "more privileges than they need...to perform their tasks." The report made several recommendations for improving organization-wide information security.

⁴Our reservations about these new procedures are discussed in our report on USAID/Washington's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (Audit

In the interim, because the new system had significant implementation problems,⁶ M/FM's Deputy Director determined USAID/Washington's accounting stations could not perform a review of their unliquidated obligations during fiscal year 1997. However, despite the fact that no reviews were conducted by USAID/Washington's accounting stations to test, among other things, whether the new system had adequate controls to ensure that only valid obligations were being recorded, the Deputy Director still signed a certification on November 24, 1997, that all recorded obligations were valid. The Deputy Director's decision not to review all USAID's obligated balances in fiscal year 1997 was identified as a material internal control weakness in our audit of USAID's fiscal year 1997 financial statements. Although we did not find that funds associated with the few invalid and potentially invalid obligations identified during the audit were used for other than legitimate U.S. Government purposes, USAID is vulnerable to fraud and anti-deficiency violations. If its new systems are less effective than its previous systems in precluding the recording of invalid obligations.

Our report on USAID's 1997 financial statements included a recommendation that the Agency's Chief Financial Officer ensure that, among other things, obligation balances are periodically reviewed so the Agency can properly certify that all recorded obligations are valid. Implementation of this recommendation will require (1) decisions as to who will be responsible for conducting reviews and (2) revised guidance as to how the reviews will be conducted and documented.⁶ We are, accordingly, not making a similar recommendation in this report. However, we believe that reviews are a secondary and belated defense and the best way to ensure that only valid obligations are recorded is to ensure that only valid obligations are executed. So that employees, particularly those in USAID/Washington, who are responsible for executing and recording obligations, have sufficient information to successfully carry out their responsibilities, we make the following recommendation:

We recommend that the Chief Financial Officer:

- 1.1 identify the types of obligations and subobligations used in the Agency and establish the minimum level of documentation that must be maintained to support the validity of each type of obligation or subobligation;**

Report No. 9-000-98-004-F, dated March 30, 1998).

⁶These problems are discussed in the OIG's report on the Audit of the Internal Controls for the New Management System (Audit Report No. A-000-97-009-P, dated September 30, 1997).

⁶Reports on USAID's Financial Statements, Internal Controls, and Compliance for Fiscal Years 1997 and 1996 (Audit Report No. 0-000-98-001-F, dated March 2, 1998).

- 1.2 **assign responsibility for maintaining the documentation and specify how long and where this documentation must be maintained so that it will be available for periodic obligation reviews, audits, and other purposes; and**
- 1.3 **make appropriate revisions to Automated Directives System Chapter 571 to ensure that reviews designed to ascertain the validity of the USAID's unliquidated obligations (a) use appropriate criteria, including 31 U.S.C. 1501(a), and (b) are conducted early in an obligation's lifecycle.**

Better Funding Guidelines and Deobligation Processes Would Reduce Pipeline

Based on our audit work, we project that about 5 percent, or \$495.0 million, of USAID's unliquidated obligations for project and non-project assistance was in excess of current requirements or no longer needed as of September 30, 1996. Excess balances fell into three major categories:

- \$305.6 million which, because of non-adherence to Agency forward funding guidelines, inadequate budgeting, or changed circumstances exceeded the amount needed within a reasonable future period;
- \$148.9 million which remained unspent after all goods and services had been provided and planned activities had been completed;
- \$40.5 million resulting from other reasons, including human error in recording the amounts to be obligated.

Likewise, there were three principal reasons why these excessive balances had not been not identified or deobligated in a timely manner:

- Agency officials sometimes did not consider the Agency's forward funding guidelines as criteria for determining whether an obligation's unspent balance was excessive. As a result, they did not target obligation balances which exceeded the guidelines for deobligation.
- Inadequate review and delays in routine financial management operations impeded timely identification of excessive balances.
- Inadequate follow-up of review results and an Agency practice of not deobligating any funds from expired or inactive obligations until all steps in the formal obligation

close-out process are completed impeded timely deobligation of balances known to be excessive.

In some cases, there were convincing reasons why funds known or believed to be excessive or unneeded had not been deobligated by the time of our audit. For example, in a few instances, deobligation processes had been initiated in a timely manner, but simply had not been completed at the time of the audit.

Our audit showed that USAID's overseas accounting stations as a group did a much better job than USAID/Washington in identifying and deobligating excess funds. We believe that the generally favorable findings for the overseas accounting stations are the result of continuing improvements such as those discussed below.'

We noted that some overseas accounting stations issued supplemental guidance or initiated new processes to help ensure that unneeded obligation balances are identified and deobligated in a timely manner. For example, REDSO/WAAC provided its missions with a breakdown of review steps and the questions to be asked, by type of obligating document. USAID/Guatemala's Controller added a quality assurance procedure to re-review a statistically valid sample of unliquidated obligations and, on instruction, from the Contracting Officer, automatically deobligates excess funds resulting from the exchange rate fluctuations, if final vouchers have been paid. USAID/Egypt's Office of Financial Management developed a detailed and thorough presentation of the pipeline status for the Mission's quarterly pipeline review to help project/activity officers keep abreast of their pipelines.

Adherence to Forward Funding Guidelines Would Reduce Pipeline

Senior USAID management reported in December 1992, that multiple reviews of USAID's pipeline during the preceding 18 months by the OIG and others, found that excessive pipelines, caused by obligating more money for activities than could be spent within reasonable periods, tied up funds in non-productive uses and gave the impression that USAID had more money than it needed. In response to these findings, the Agency (1) revised its forward funding guidelines and began the practice of issuing them as part of annual guidance for budget preparation and submissions, (2) directed bureaus to build concern about excess pipelines into their annual portfolio reviews, and (3) revised the standard provisions for bilateral agreements to allow for unilateral deobligation of excess balances. Bureaus could request exemptions to the guidelines for country-specific reasons and USAID/Egypt was granted such an exemption.

'See Appendix IV for a breakdown of our review results for USAID/Washington, USAID/Egypt, and all other overseas accounting stations.

USAID has issued forward funding guidelines since at least 1978. The guidelines, which typically are included in annual instructions for preparing budget submissions, have been worded somewhat differently over the years. The version included in guidance for fiscal year 1996's budget submissions (the most current year covered by our audit) stated that obligations should be sufficient to fund anticipated expenses for no more than 12 months beyond the end of the fiscal year in which the obligation takes place. Obligations for participant training, construction activities, policy-conditioned non-project assistance, and new projects were subject to somewhat different standards. For example, obligations for new projects or activities should provide funding for at least 18 months, but not more than 24 months.

For the purpose of this audit, we applied the guidelines as follows when determining whether an obligation balance should be considered excessive:

Obligations for new fiscal year 1996 activities - In general, we considered obligation balances to be reasonable as of September 30, 1996, if they provided funds for anticipated expenses for a period of 24 months following the date of obligation or through September 30, 1997, whichever was later.

Obligations for continuing activities - In general, we considered obligation balances to be reasonable as of September 30, 1996, if they provided funds for anticipated expenses (1) for the 12-month period ending September 30, 1997; (2) through the expiration date of the obligating document; or (3) through the project assistance completion date, whichever was earlier. In making these assessments, we considered whether balances of other funding increments affected the continuing need for part or all of the unliquidated balance being audited.

Using this interpretation, we projected that, because of lack of compliance with the Agency's forward funding policy, about 3 percent, or \$264.6 million, of USAID's unliquidated obligations was excessive on September 30, 1996. However, by the time of our audits, which took place 9 to 14 months after September 30, 1996, the balances of many of these obligations had been reduced to amounts that were no longer considered excessive. It should be noted that our estimates and fieldwork were not designed and cannot be used to identify any bureau-to-bureau or region-to-region differences.

An analysis of the USAID Budget Business Area, issued in August 1994, succinctly described why excess balances persist and their detrimental effect. "There is a large degree of uncertainty about future resource availability. Consequently, individual organizations try to build up buffers of funds to see them through possible lean times. This tactic is used throughout the Agency to squirrel away money in all accounts. This can distort planning by tying up funds in unnecessarily large pipelines that may drain money away from other higher priority activities."

USAID officers offered several other reasons for not complying **with** the guidelines. Some believed the guidelines are impractical due to the nature of Agency programs and projects. Some said that in order to meet Congressional earmarks, bureaus might give a mission more than it requested or could use earmarks, thereby constituting a violation of the guidelines. Others said the guidance could not be used in funding annual workplans which cover calendar rather than fiscal years. Some mentioned that when missions receive budget allowances late in a fiscal year, they are unable to make obligations for the last quarter of annual work plans without violating the forward funding guidance. Some thought compliance was optional, others thought that it applied only to budget planning processes. Some contract and project officers said they ignored the guidance because they wanted to avoid the additional paperwork associated with incremental funding. And finally, many were not aware or only vaguely aware of the guidelines.

In our opinion, the guidelines were inadequately disseminated and did not provide sufficient information to ensure familiarity and compliance. For example, although the guidelines discuss limiting funding for obligations, it is not clear how the guidelines are intended to be applied to subobligations. In addition, we were told that the guidelines, because they were articulated in annual budget preparation instructions, were not necessarily shared with the project/activity managers or procurement officers who typically develop the detailed budgets for initial and incremental obligations and subobligations. In addition, because the guidelines were not included in the criteria used for periodic obligation reviews, reviewers did not use them to identify funds for potential deobligation.

We agree with the Agency that forward funding limits are an important part of good cash management practices. However, based on the results of our audit, we do not believe that USAID has done enough to ensure that its guidelines are understood and implemented by the staff who actually calculate the budgets for incrementally funded obligations and subobligations. We recommend the following:

Recommendation No. 2: We recommend that the Office of Budget of the Bureau for Management issue policies and procedures, in the Agency's Automated Directives System, that clarify how the Agency's forward funding guidelines should be implemented at the obligation and subobligation level and assign responsibility for their enforcement.

Timely Identification and Deobligation of Unneeded Funds Would Reduce the Pipeline

We projected that about 2 percent, or \$148.9 million, of the Agency's fiscal year 1996 unliquidated obligations could have been deobligated before September 30, 1996. Many balances identified as excessive in fiscal year 1996 had not been deobligated at the time of our audit in fiscal year 1998. These funds were not deobligated in a timely manner

for the following principal reasons. First, steps were not taken during periodic obligation reviews which would have alerted responsible financial, procurement, or program staff that an obligation had expired or activity had been completed or was expected to do so in the near future. Particularly in **USAID/Washington**, when obligations with excess balances were identified, follow-up action by financial, program, and procurement staff was unmethodical and disconnected. Second, it has been an Agency practice not to deobligate any funds from expired or inactive obligations until all administrative close-out procedures are completed. These steps include receiving and paying final invoices, receiving and processing **advices of charge*** from other **USAID** offices, obtaining all unspent advances due from contractors or grantees, and completing overhead or incurred costs audits. These steps can take years to complete and, in the meantime, the entire unspent balance is retained, even if the remaining balance is far more than was considered to be needed to safely meet potential expenses. Third, we found instances of inadequate and insufficient activity budgeting. In some cases, there was no evidence that financial plans or budgets had been prepared to support the amounts obligated and in others, no effort was made to reassess budgets or financial plans when an activity's scope was reduced during the course of implementation. Fourth, the Agency's requirement that deobligated funds be returned to **USAID/Washington** for reallocation, possibly to other missions, may have been a disincentive to timely deobligations. Finally, we found that reviewers tended to focus their attention on obligations which are approaching their completion dates rather than focusing on all unliquidated obligations as the Agency guidelines prescribe.

The U.S. General Accounting Office's (GAO) Standards for Internal Controls in the Federal Government require the prompt, timely, and accurate recording of transactions, including deobligations. Prompt recording ensures that pertinent information maintains its relevance and value to management in controlling operations and making timely and effective decisions. With respect to Federal obligations, GAO stated that because the precise amount of the government's liability is frequently not known at the time an obligation is incurred, the obligation should be recorded on the basis of the Agency's best estimate. When an estimate is used, the basis for the estimate must be shown on the obligating document. As more precise data on the liability become available, the obligation must be periodically adjusted. In addition, **USAID's** guidance on Project Accounting prescribes that, when a portion of the obligated funds is determined to be no longer needed to complete the project goals, the amount so determined can be deobligated. Furthermore, guidance issued by M/FM to those conducting section 1311 reviews contains various provisions to ensure timely deobligations. These include:

- A requirement that a review of all recorded unliquidated obligations/commitments be completed by the end of the third quarter of the fiscal year. The timing of this review

*Advice of Charge - A **USAID** accounting document used to transfer expenditures or credits between accounting offices.

is deemed especially important to the USAID planning process to permit timely and orderly realallowances and reobligations prior to the end of the fiscal year.

- M/FM accountants and mission controllers are instructed both to alert contract officials of expired and/or soon to expire obligations and to actively follow-up to ensure action is undertaken and approved in a timely manner.
- Reviewers are instructed to include the name of financial management, program, project, or executive officer who jointly reviewed the obligation/commitment, along with related action to be taken to appropriately adjust the affected accounts.

We found instances of noncompliance with the preceding requirements both overseas and in USAID/Washington, although instances of non-compliance were greater at USAID/Washington, where obligations constituted only 45 percent of the Agency's total unliquidated obligations, but 72 percent of the amount estimated to be excessive. In addition to reporting on conditions leading to excess balances, our collateral report on USAID/Washington⁹ recommends the deobligation of \$20.2 million associated with 104 obligations and recommends corrective actions to ensure the timely identification and deobligation of unneeded funds in the future.

Although the deficiencies noted in our mission-level audits varied in importance, correction of the most common would be beneficial. We found, for example, that several missions had excluded funds which had not been subobligated from their reviews of unliquidated obligations. This was a concern because these funds can be substantial and remain idle for long periods without clear plans for their use. In most cases, because M/FM's review guidance was very comprehensive, it appeared that a strong reminder to follow existing guidance, perhaps accompanied by additional training was all that was required. Considering the results of this audit and recommendations cited earlier, we recommend the following:

Recommendation No. 3: We recommend that the Bureau for Management develop a training course and/or training video, to be provided to appropriate staff, describing roles and responsibilities for reviewing unliquidated obligations.

Management Comments and Our Evaluation

USAID's Bureau for Management agreed with the report's findings and promptly began to develop plans to implement its recommendations. The Agency has decided to conduct

⁹Audit of USAID/Washington's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (Audit Report No. 9-000-98-004-F, dated March 30, 1998).

a major, multi-office review of the necessary steps and parties involved in effective management of obligations. This start-to-finish analysis will cover the complete obligation process, from what constitutes a valid obligation, through periodic pipeline reviews, to award closeout processes. Management further intends to codify the results of this assessment as additions or revisions to essential policies and procedures in the Agency's Automated Directives System. We believe that the increased focus on the need for systems and controls to ensure that only valid obligations are executed and recorded and that obligation balances are thoroughly reviewed at pre-determined intervals will have a major and positive impact on the Agency's ability to effectively manage the funds appropriated to it.

Specifically, Agency management agreed to make appropriate revisions to its Automated Directives System to ensure that only valid obligations are recorded and appropriate documentation to support the validity of individual obligations is retained for review and other purposes. Efforts to delineate roles and responsibilities for ensuring the validity of obligations commenced with negotiations between the Agency's Financial Management and Procurement Offices to draft a memorandum of understanding on their respective roles. Finally, Agency management agreed to establish policies and procedures that will ensure that adequate reviews are conducted to support the Agency's certification of the validity of its obligations.

To improve its management of unliquidated obligations, Agency management agreed to clarify and incorporate its forward funding guidelines in the Agency's Automated Directives System. The Agency also agreed to ensure that increased attention will be given to pipeline issues in USAID's annual budget reviews and to incorporate these issues into Agency-wide training to be developed by the Bureau for Management. As stated on page one of this report, although we agree with management's planned corrective actions for all recommendations, we are withholding our concurrence with Recommendation No. 3 pending receipt of management's comments concerning the amount of potential savings that would result from its planned corrective actions.

SCOPE AND METHODOLOGY

Scope

This audit of USAID's obligations for project and non-project assistance was conducted under the direction of the Office of Inspector General's (OIG) Division of Performance Audits (IG/A/PA) with the assistance of all Regional Inspectors General for audit. The audit followed generally accepted government auditing standards.

In designing our audit tests and procedures as well as in determining whether a matter requires disclosure in our audit report, we considered the materiality and/or significance threshold level for this audit to be a five percent rate of non-compliance or non-achievement. We chose this rate principally because previous OIG and U.S. General Accounting Office (GAO) audits, including OIG's audit of the Agency's compliance with the Government Management and Reform Act of 1994 and the USAID's 1996 Federal Managers' Financial Integrity Act (FMFIA) assessment found several major weaknesses in the Agency's financial management systems. This threshold level was agreed to by senior management of USAID's Office of Financial Management of the Bureau for Management (M/FM).

The audit was limited to obligations for project and non-project assistance which had unliquidated balances on September 30, 1996. It did not cover obligations recorded into a new USAID/Washington accounting system, U.S.-owned local currency, obligations for disaster relief, or obligations maintained by USAID for the Trade and Development Agency.

The audit was conducted from January 1997 through February 1998, at USAID offices in Washington, D.C. and 18 overseas locations (see list in Appendix III).

Because USAID did not have an integrated database or other single source which could provide a list of all USAID obligations for project and non-project assistance with unliquidated balances on September 30, 1996, we found it necessary to compile our own list. Accordingly, IG/A/PA requested USAID's 40 accounting stations to compile and provide us such lists. The sum of the unliquidated balances was \$9,736,984,932. Because the accuracy and completeness of the lists of obligations provided to us was crucial to our ability to make Agency-wide projections, we validated these lists at those sites where we conducted detailed audit work. In addition, we compared the total amount

obligations reported to us with appropriation account balances reported by M/FM to the U.S. Treasury and found them to be very close, giving us the assurance that no significant number of obligations had been inadvertently overlooked. We did not, however, independently validate whether the unliquidated balances of these obligations were accurate; i.e., payments, refunds, and/or deobligations had been correctly recorded.

Using a combination of stratified, two-stage cluster, and probability-proportional-to-size sampling methodologies, we randomly selected obligations totalling \$2,674,830,730 from the lists provided us for detailed audit testing. The combination of these sampling methodologies allowed us to make Agency-wide projections based on field work performed at a limited number of sites.

Methodology

The audit was designed to determine whether USAID reviewed and certified unliquidated obligations in accordance with applicable U.S. Government laws and regulations, and USAID policies and procedures.

We reviewed each obligation, including all related subobligations, which had an unliquidated balance as of September 30, 1996, to determine whether (1) the obligation was valid in accordance with the provisions of 31 U.S.C. 1501(a) and decisions of the U.S. General Accounting Office (GAO) and (2) the unliquidated balance was needed, in full or in part, to cover anticipated expenses during reasonable future periods.

In making these decisions, we considered the GAO guidance, Agency and mission guidance for forward funding, activity-specific budgets and spending plans, actual disbursements, progress reports, and accruals. When the validity of an obligation or the need for its balance appeared questionable, we interviewed relevant activity managers and contracting or grant officers. When application of relevant policies and legality of obligation documentation were questioned, we interviewed policy officers from the Office of General Counsel and Bureau of Policy and Planning Coordination.

Projected throughout this report is an estimate of the amount of the Agency's total balance of **unliquidated** obligations (as of September 30, 1996) which would have been found to be excessive if the entire universe of obligations had been reviewed. This estimate falls within a range of 76.6 percentage points to 123.4 percentage points, at a 95 percent confidence level. In other words, if all unliquidated obligations had been reviewed, there is a 95 percent probability that the results obtained would not differ from the sample estimates, in the most extreme case, by more than ± 23.4 percentage points.



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MAR 25 1997

MEMORANDUM

TO: AIG/A, Everette B. Orr

FROM: AA/M, Terrence J. Brown *TJB*

SUBJECT: Audit of USAID's Review and Certification of
Unliquidated Obligations for Project and Non-Project
Assistance as of 9/30/96, Draft Report No. 9-000-98-
00X-F

Thank you for the opportunity to respond to the subject draft report. It presents a balanced view of the issues resulting from your worldwide review of unliquidated obligations as of September 30, 1996, and the challenges we face due to the activation of new accounting and management systems. We agree that clarified procedures related to forward funding guideline6 and more timely action on contract close-out would lead to more efficient resource management. We also appreciate your acknowledgement that practices and processes in place during FY 96 were improved from previous years.

A response to your draft report on the Washington review will be provided separately. Our comments on the recommendations from this report are as follows:

Recommendation 1: We recommend that the Chief Financial Officer:

1.1 identify the types of obligations and subobligations used in the Agency and establish the minimum level of documentation that must be maintained to support the validity of each type of obligation or subobligation.

1.2 assign responsibility for maintaining the documentation and specify how long and where this documentation must be maintained so that it will be ● milsbl@ for periodic obligation reviews, audits, and other purposes.

1.3 make appropriate revisions to ADS Chapter 571 to ensure that reviews designed to ascertain the validity of USAID's unliquidated obligations (8) use ● ppXOpri8ts criteria, including 31 U.S.C. 1501(a); sad (b) are conducted early in an obligation's lifecycle.

We agree with these recommendations and have made a management

decision to implement the recommended actions. AS an initial effort, a memorandum of understanding has been drafted between FM and OP which outlines the responsibilities and procedures to be followed by OP and warranted contracting officers with respect to their role in signing award documents. Final action will be considered when the policies and procedures required by these recommendations have been established and incorporated into MS Chapter 571.

Recommendation 2: We recommend that the Office of Budget of the Bureau for Management issue policies and procedures, in the Agency's ADS, that clarify how the Agency's forward funding guidelines should be implemented at the obligation and subobligation level and ● 88im responsibility for their enforcement.

We agree with this recommendation. A management decision has been made to clarify the forward funding guidance and incorporate it into the ADS system. This recommendation will be reviewed for closure when the ADS guidance is issued.

Recommendation 3: We recommend that the Bureau for Management, after decisions have been made regarding the role8 and responsibilities of USAID's financial, procurement, and program offices or bureaus, develop a training course and/or training video which can be provided to all staff in those offices or bureaus responsible for reviewing unliquidated obligations.

We concur with this recommendation. A management decision has been made to establish policies and procedures that will ensure adequate reviews are conducted of unliquidated obligations to certify their validity and to properly manage our pipeline. We will also assure that increased attention is given to pipeline issues in USAID's annual budget reviews. In addition, we will incorporate these issues in the material we are developing for use in Agency-wide implementation training.

We will conduct a management analysis to identify the necessary steps and parties involved to effectively manage an obligation from award through the closeout cycle. In addition, M/FM is revising and expanding ADS Chapter 571 to address the complete obligation process, from what constitutes an obligation, through the validation process, and balance status reporting. The responsibility for specific activities will be defined as determined by the management study and in consideration of the new operational environment. The chapter will also identify those requirements established as a result of implementing recommendations 1.1, 1.2 and 1.3.

This recommendation will be reviewed for final action when the policies and procedures are in place, and the requirements have been incorporated into the training program.

**AUDIT SITES AND SITE-SPECIFIC AUDIT REPORTS
ISSUED AS PART OF THE WORLDWIDE AUDIT**

AUDIT SITES	AUDIT REPORTS ISSUED
USAID/Washington	Audit of USAID/Washington's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 9-000-98-004-F, March 30, 1998)
USAID/Bolivia	Audit of USAID/Bolivia's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 1-511-98-002-F, January 6, 1998)
USAID/Botswana	Audit of USAID/RCSA's Review and Certification of USAID/Botswana's Unliquidated Obligations for Project and Non-Project Assistance (No. 4-690-98-001-F, October 1, 1997)
USAID/Ecuador	Audit of USAID/Ecuador's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 1-5 18-98-001-F , November 6, 1997)
USAID/Egypt	Audit of USAID/Egypt's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 6-263-98-001-F , December 30, 1997)
USAID/El Salvador	Audit of USAID/El Salvador's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 1-519-98-003-F, March 18, 1998)
USAID/Guatemala	Audit of USAID/Guatemala's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 9-000-98-001-F, January 30, 1998)
USAID/Honduras	Audit of USAID/Honduras' Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 1-522-98-004-F, March 26, 1998)
USAID/Indonesia	Audit of USAID/Indonesia's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 5-497-98-002-F, December 31, 1997)

AUDIT SITES	AUDIT REPORTS ISSUED
USAID/Mali	<p>Audit of USAID/Mali's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 7-688-97-001-F, September 19, 1997)</p> <p>Survey Report on Excess Fiscal Year 1997 Self-Help Obligations and an Internal Control Weakness Found During the Audit of USAID/Mali's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 7-688-97-006-S, September 19, 1997)</p>
USAID/Moscow	Audit of USAID/Moscow's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. B-1 18-98-002-F, January 16, 1998)
USAID/Namibia	Audit of USAID/Zimbabwe's Review and Certification of USAID/Namibia's Unliquidated Obligations for Project and Non-Project Assistance (No. 4-673-98-002-F, October 2, 1997)
USAID/Nepal	Audit of USAID/Nepal's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 5-367-98-003-F, December 31, 1997)
USAID/Philippines	Audit of USAID/Philippines' Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 5-492-98-005-F, January 30, 1998)
USAID/Philippines for USAID/Thailand	Audit of USAID/Philippines' Review and Certification of the Regional Support Mission/East Asia's Unliquidated Obligations for Project and Non-Project Assistance (No. 5-492-98-004-F, January 30, 1998)
OAR/Poland	Audit of OAR/Poland's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. B-181-98-001-F , December 10, 1997)
USAID/REDSO/WCA	Audit of USAID/REDSO/WCA's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 7-624-98-001-F, February 6, 1998)
USAID/South Africa	Audit of USAID/South Africa's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 4-674-98-003-F, November 17, 1997)
USAID/Zambia	Audit of USAID/Zambia's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance (No. 4-611-98-004-F, November 21, 1997)

**Statistical Projections for Excessive Amounts of
USAID'S Unliquidated Obligations as of 9/30/96
(Based on 95 Percent Confidence Intervals)**

Estimates of Total Excessive Obligations	USAID-wide	USAID/ Washington	USAID/ Egypt	Other Missions
Best Unbiased Estimate	\$495,007,491	\$357,859,126	--	\$137,148,365
Lower Bound	\$379,080,683	\$261,283,974	--	\$ 73,021,422
Upper Bound	\$612,934,299	\$454,434,278	--	\$201,275,308
Relative Precision	(+/-) 23.4%	(+/-) 27.0%	--	(+/-) 46.8%

**Statistical Projections for Obligations Deemed Excessive Because
Funded Goods and Services were Delivered and/or Activities were Completed
(Based on 95 Percent Confidence Intervals)**

Estimates of Total Excessive Obligations	USAID-wide	USAID/ Washington	USAID/ Egypt	Other Missions
Best Unbiased Estimate	\$148,901,838	\$113,672,450	--	\$35,229,388
Lower Bound	\$ 96,488,727	\$ 66,747,663	--	\$11,879,899
Upper Bound	\$201,314,949	\$ 160,597,237	--	\$58,578,877
Relative Precision	(+/-) 35.2%	(+/-) 41.3%	--	(+/-) 66.3%

**Statistical Projections for Obligations Deemed Excessive Because
Remaining Funds Not Expected to be Needed Within a Reasonable Future Period
(Based on 95 Percent Confidence Intervals)**

Estimates of Total Excessive Obligations	USAID-wide	USAID/ Washington	USAID/ Egypt	Other Missions
Best Unbiased Estimate	\$305,609,090	\$203,688,810	--	\$101,920,280
Lower Bound	\$200,989,546	\$121,665,941	--	\$ 36,978,015
Upper Bound	\$410,228,634	\$285,711,679	--	\$166,862,546
Relative Precision	(+/-) 34.2%	(+/-) 40.3%	--	(+/-) 63.7%